KPMG

STATE OF ALASKA
GROUP HEALTH AND LIFE FUND

(an Internal Service Fund of the State of Alaska)

Financial Statements

June 30, 1998

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KPMG Peat Marwick LLP

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Independent Auditors' Report

Division of Retirement and Benefits
Group Health and Life Fund:

We have audited the accompanying balance sheet of the State of Alaska Group Health and Life Fund (Plan), an Internal Service Fund of the State of Alaska, as of June 30, 1998, and the related statements of revenues, expenses and changes in retained earnings (deficit), and cash flows for the year then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of Alaska Group Health and Life Fund (Plan), an Internal Service Fund of the State of Alaska, as of June 30, 1998, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

KPMG Peat Marwick LLP

September 24, 1998

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Balance Sheet

June 30, 1998

Assets:		
Investment in State of Alaska General Fund and other non-segregated investments pool (note 3)	$	10,571,218
Deposit with NYLCare (note 4)		1,569,352
Total assets	$	12,140,570
Liabilities and Fund Equity:		
Liabilities:		
Accrued expenses	$	482,063
Estimated claims incurred but not paid (note 5)		15,192,673
Total liabilities		15,674,736
Fund equity:		
Deficit (note 1)		(3,534,166)
Total liabilities and fund equity	$	12,140,570

See accompanying notes to financial statements.

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Statement of Revenues, Expenses and Changes in Retained Earnings (Deficit)

For the year ended June 30, 1998

Revenues:		
Health insurance premiums (note 6)	$	74,004,772
Expenses:		
Benefits		74,036,836
Administrative expenses		4,603,717
Total expenses		78,640,553
Operating loss		(4,635,781)
Investment income		1,101,615
Net loss		(3,534,166)
Retained earnings, beginning of year		—
Deficit, end of year	$	(3,534,166)

See accompanying notes to financial statements.

STATE OF ALASKA
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Statement of Cash Flows

For the year ended June 30, 1998

Operating activities:		
Operating loss	$	(4,635,781)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Increase in accrued expenses		482,063
Increase in estimated claims incurred but not paid		15,192,673
Net cash provided by operating activities		11,038,955
Investing activities:		
Investment income		1,101,615
Net increase in cash		12,140,570
Cash and cash equivalents, beginning of year		—
Cash and cash equivalents, end of year	$	12,140,570

See accompanying notes to financial statements.

(1) DESCRIPTION

The following brief description of the State of Alaska Group Health and Life Fund (Plan), an internal service fund of the State of Alaska (State), is provided for general information purposes only. Participants should refer to the Employee Group Insurance Information Booklet for more complete information.

(a) General

The Plan was established to provide self-insured healthcare benefits to eligible employees of the State of Alaska beginning July 1, 1997. The Plan is an internal service fund of the State financial reporting entity and is included as such in the State's financial reports. As of June 30, 1998, there were approximately 11,000 employees, excluding dependents, covered by the Plan.

Prior to July 1, 1997, healthcare benefits for State employees were fully insured through the payment of premiums to an insurance company.

(b) Benefits

The Plan offers medical, dental and vision benefits to eligible State employees and their dependents.

<u>Eligibility</u>

This Plan does not provide benefits to members of the following collective bargaining agreements:

- Labor, Trades and Crafts Unit
- Public Safety-Airport Security Unit
- Public Safety-Troopers Unit
- Correspondence Teachers Unit

All other permanent employees of the State are covered by the Plan, including permanent seasonal and permanent part-time employees.

The Plan also provides coverage for State legislators and elected officials.

Non-Flexible Benefits

Employees who are members of the general government and correctional officers collective bargaining units are eligible for non-flexible healthcare benefits. The premium for these benefits are split between the State and the employee in accordance with the provisions of the appropriate collective bargaining unit. In addition to the benefits offered under the non-flexible program, employees can also elect to obtain additional medical coverage under Option 1 of the State of Alaska Supplemental Benefits System. Premiums for this additional coverage are funded by pre-tax deductions from the employees' paychecks.

Flexible Benefits

Employees who are members of collective bargaining units other than general government and correctional officers are eligible for flexible healthcare benefits. Under this program, employees are provided benefit credits by the State which they can use to purchase the benefits they want. Benefits credits equal the amount that the State contributes towards benefits for employees. The amount of benefits credits that each employee receives is decided by the legislature and/or the appropriate collective bargaining agreement and can be adjusted each year. Each of the available options offers different benefits or pays benefits at different rates. If the cost of the benefit option selected by an employee exceeds the amount of their benefit credits, the difference is funded by the employee through pre-tax payroll deductions. If the cost of the benefit option selected by an employee is less than the amount of their benefits credits, the remaining benefits credits are contributed to a health care reimbursement account for that employee.

(c) ***Administration***

The Plan is administered by the State's Division of Retirement and Benefits (DRB). DRB utilizes the services of a claims administrator, NYLCare Health Plans (NYLCare), to process all medical and dental claims. NYLCare has contracted with Express Scripts, Inc. (ESI) to process prescription drug claims for the State. Vision benefits provided by the Plan are administered by Vision Service Plan (VSP).

(d) ***Funding***

The Plan is self-insured for all benefits. The Plan's funding policy provides for the collection of premiums from employees, if applicable, and the State. Premium amounts are actuarially determined on an annual basis and adjusted as necessary. The State retains the risk of loss of allowable claims.

At June 30, 1998, the Plan has a deficit fund balance of $3,534,166. In accordance with State employee bargaining unit contracts, premiums collected will be reviewed on an annual basis and when the premiums received are not sufficient to pay claims, resulting in a deficit fund balance, premiums will be increased the following year as appropriate. Management expects the deficit fund balance at year end to be offset by premium increases and/or investment income during the next fiscal year.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Accounting

The Plan's financial statements are prepared using the accrual basis of accounting. Premiums are recognized in the period in which they are due. Benefits are recognized when due and payable.

(b) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(c) Investments

Investments are recorded at fair value. Fair value is "the amount that a plan can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller - that is, other than in a forced or liquidation sale."

The Plan is a participant in the State General Fund and Other Non-Segregated Investments (GeFONSI) pool. GeFONSI is comprised of the invested assets of the State General Fund and certain other funds that are commingled for investment purposes. GeFONSI invests primarily in pooled marketable debt securities.

Fair value pricing of pooled marketable debt securities is performed daily by the custodian utilizing an independent pricing service. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates, if applicable. Securities not traded on a national or international exchange are based on equivalent values of comparable securities with interest rates for similar instruments. Fair value has been established as the midpoint between the bid and asked prices. The cost of debt and equity investments is determined on the average cost basis.

GeFONSI investment income is distributed to participants as prescribed by statute or if appropriated by the State legislature.

(d) ***Statement of Cash Flows***

For purposes of reporting cash flows, cash and cash equivalents include the Plan's investment in GeFONSI and the Plan's deposit with NYLCare. Both of these balances have the general characteristics of demand deposit accounts.

(e) ***Federal Income Tax Status***

The Plan is exempt from federal income taxes under Section 501(a).

(3) CUSTODIAL CREDIT RISK

The Governmental Accounting Standards Board (GASB) Statement No. 3 requires a disclosure regarding custodial credit risk to indicate the chance of loss in the event a financial institution or third party holding the Plan's securities fails. At June 30, 1998, the Plan's investments are represented by participation in GeFONSI, which primarily invests in pooled fixed income securities. Although pooled fixed income securities represent the GeFONSI's share of ownership in the pool rather than ownership of specific securities, all of the underlying securities in the pools in which the GeFONSI participates are considered to be Category 1 as defined by GASB Statement No. 3. As such, investments are insured or registered, or securities are held by the State or its custodian in the State's name. Category 1 is the highest level of safekeeping security as defined by GASB. The deposit with NYLCare (note 4) is classified as category 3 because the related bank account is not in the State's name.

(4) DEPOSIT WITH NYLCare

The Plan is required to maintain a cash balance with NYLCare for the payment of medical and dental claims. The cash balance also facilitates the payment of valid prescription drug and vision claims and is used to pay ESI and VSP, respectively. Amounts disbursed from the cash balance are reimbursed by the Plan to NYLCare on a weekly basis.

(5) CLAIMS INCURRED BUT NOT PAID

The Plan has established a liability as of June 30, 1998 for estimated claims incurred but not paid. This amount was actuarially estimated using the completion factor approach. The underlying principle of this approach is that contingencies affecting the progression of claims payments for a particular claim are inherently and properly modeled by an assumed runoff pattern. This runoff pattern is used to estimate claims incurred before year-end but not paid until subsequent to year-end.

(6) PREMIUMS

During the year ended June 30, 1998, the Plan received a $1,000,000 refund of reserves from the insurance company which provided coverage to retirees prior to July 1, 1997. These reserves were retained by the insurance company to cover claims submitted subsequent to July 1, 1997, but incurred prior to that date. The refund amount is reflected as health insurance premiums in the financial statements.